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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1975

No. 75-795

JAMES CISSELL, Trustee,

Appellant,

v.

AMERICAN HOME ASSURANCE CO.,

Appellee.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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LOWER COURT OPINIONS

The opinions of the United States District Court for the Southern District of Ohio, Western Division and of the United States Court of Appeals for the Sixth Circuit are attached hereto as Appendices A and B; they have not been reported.

JURISDICTION

An opinion was filed and judgment was entered in this case by the United States Court of Appeals for the Sixth Circuit on September 9, 1975. Section 1254 of Revised Title 28 of the United States Code confers jurisdiction on

this Court to review the judgment in question by writ of certiorari.

QUESTIONS FOR REVIEW

A. Does a trustee in bankruptcy have standing to bring an action seeking a declaratory judgment as to the rights and obligations of the trustee under a policy of insurance issued to the bankrupt?

B. Does a trustee in bankruptcy have standing to sue the insurer of the bankrupt on claims against the bankrupt which arose at or subsequent to the time of filing bankruptcy and which have been or will be approved by the court?

STATUTES INVOLVED

Federal Declaratory Judgment Act, 28 U.S.C., Sec. 2201:

> "*Creation of Remedy* — In a case of actual controversy within its jurisdiction, except with respect to federal taxes, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such."

Bankruptcy Act, 11 U.S.C., Sec. 110. For Text, see Appendix C.

STATEMENT OF THE CASE

World Academy was a travel organization which provided its customers with trips to Europe lasting approximately 40 days at a charge of about $1,000. At the beginning of July, 1970, World Academy had available cash

of about $300,000.00 and assets of about $2,000,000.00. Approximately 2,000 students had begun their travel in Europe and an additional 2,000 were getting ready to leave their homes for Europe when the company management decided to file bankruptcy.

World Academy had purchased an errors and omissions insurance policy from American Home Assurance Company. In the policy the company agreed to,

> ". . . pay on behalf of the insured all sums which the insured shall become legally obligated to pay because of: . . . any negligent act, error, or omission of the insured or any other person for whose acts the insured is legally liable in the conduct of travel agency operations by the named insured . . ."

The policy further provided that,

> "No action shall lie against the company unless, as a condition precedent thereto, there shall have been full compliance with all of the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company."

and

> ". . . Bankruptcy or insolvency of the insured or of the insured's estate shall not relieve the company of any of its obligation hereunder."

Eventually, claims from the travel customers and others who had received inadequate performance, or nothing, because of the failure to perform, were filed with the trustee in bankruptcy. The trustee took the position that if World Academy had completed the student travel pro-

gram and then declared bankruptcy, there would not have been claims under the policy for "errors or omissions in travel agency operations" — the bankruptcy would have been a routine commercial or mercantile bankruptcy. Nevertheless, bankruptcy petitions were filed and the student travel program was not carried out. It should be noted here that a substantial portion of the European expense had been prepaid by World Academy and that to carry out the 1970 summer travel program would have involved additional expenditures but not the complete apparent expense of providing the program for more than 4,000 travelers. Defendant insurance company was requested to pay the claims but denied coverage for the claims under the policy.

Plaintiff, as trustee in bankruptcy, delayed allowing or disallowing individual claims because the policy requires defendant's participation in the suffering of a judgment, and allowance of a claim in bankruptcy has been held to be equivalent to a judgment.

On March 9, 1971, James Cissell, Trustee for World Academy, and appellant here, sued American Home Assurance Company, appellee here, in the United States District Court for the Southern District of Ohio, Western Division. Among other things, plaintiff alleged that he was trustee in bankruptcy of World Academy and its affiliates, that he was a citizen of the state of Ohio, and that the described corporation bankruptcies were pending before that same Court. Plaintiff further alleged that defendant was an insurance company having its principal place of business in the state of New York, and that the amount in controversy exceeded $10,000. Plaintiff trustee prayed in his Complaint that the Court find that the defendant insurance company was liable to plaintiff in the policy amount, or in the alternative, that the Court,

> ". . . make a finding as to respective obligations of the Plaintiff Trustee in presenting claims to the Referee in Bankruptcy for approval, and of Defendant in connection with the Referee's rulings as to their effect as judgments, and that the Court further make a declaratory judgment as to the rights and obligations of the parties, and that the Court set a procedure to be followed by Plaintiff and Defendant in the presentation and requests to the Referee in Bankruptcy for allowance of claims under the said insurance policy."

Defendant claimed that the policy language did not cover the losses for which the suit was filed, that the policy had been issued as a result of fraudulent misrepresentations, that plaintiff had no standing to sue, that the Court was without jurisdiction, and that the principles of subrogation defeated plaintiff's claim. The case was tried to District Judge Timothy Hogan without a jury and he filed his decision on September 25, 1974. Judge Hogan characterized the action:

> "Basically, the Complaint as filed was for a declaratory judgment determining not only certain substantive questions, but also certain procedural questions — in its latter aspect the action basically was one by a court-appointed officer, seeking instructions for that officer in a quandary." Appendix A, at 2a.

The Court ruled in favor of plaintiff trustee on each of several issues except the question of insurance policy coverage and ruled against defendant insurance company on its defenses and counter-claims. Plaintiff trustee appealed to the Court of Appeals for the Sixth Circuit on the issues of the District Court's interpretation of the insurance policy and not submitting factual issue to a jury. On cross-appeal, defendant insurance company urged:

1) that the plaintiff had no standing to bring the action;

2) that the jurisdictional amount was not present; and

3) that the defendant's contractual obligation was discharged by virtue of the plaintiff's claimed release of parties primarily liable.

The Court of Appeals for the Sixth Circuit filed its decision on September 9, 1975. In the Court's opinion the action was characterized as:

> "The Complaint sought interpretation of the policy, a declaration of rights and obligations of the parties, and instructions to the trustee in bankruptcy as to the manner in which claims of student creditors (customers of World Academy) should be presented to the bankruptcy judge." Appendix B, at 33a.

The Court of Appeals then held that plaintiff trustee had no standing to bring that action. There was no discussion of the other questions presented by the appeal.

ARGUMENT FAVORING REVIEW

A. The Sixth Circuit Court of Appeals misinterpreted the Federal Declaratory Judgment Act (28 U.S.C., Sec. 2201) in holding that a trustee in bankruptcy has no standing to bring a declaratory judgment action to determine the coverage of an insurance policy which had been purchased by the bankrupt. In both the District Court opinion and the opinion of the Court of Appeals, it was recognized that this suit was, by its nature, one for a declaratory judgment; a request for guidance as to the rights and duties of the parties to an insurance policy so that the trustee might act in the best interest of the bankrupt's estate. The District Court attempted to provide that guidance but, the trustee

believed, erred in its interpretation of the policy coverage. The Court of Appeals, while stating the nature of the suit to be that of a declaratory judgment action, failed to proceed accordingly and digressed in the opinion. The Court addressed itself only to the question of "standing to sue" – there was not a meaningful review of the District Court's detailed and lengthy finding and the "standing to sue" question was incorrectly decided. By ordering dismissal of the Complaint, the Court of Appeals wiped away even the District Court's attempt to provide a declaratory judgment.

The Federal Declaratory Judgment Act provides in part that the Court,

> ". . . may declare the rights and other legal relations of *any interested party* seeking such declaration whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree *and shall be reviewable as such.*" (Emphasis added) 28 U.S.C., Sec. 2201.

Because of its failure to discuss this aspect of the holding, the Court's rationale for denying standing, and thus a review of the District Court declaration and judgment, cannot be commented upon. Whatever the reasoning, however, we submit it was error to so hold. The plain language of the Act states that "any interested party" may seek such relief. One of the parties to an insurance contract certainly has the required interest to request a declaration as to coverage concerning existing claims. See *State Farm Mutual Auto Ins. Co.* v. *Massey,* 195 F. 2d 56, (7th Cir. 1952) *cert. denied* 344 U.S. 869; *Employers Liability Assur. Corp.* v. *Ryan,* 109 F. 2d 690, (6th Cir. 1940) *cert. dismissed* 311 U.S. 722; *Businessmen's Assurance Co.* v. *Sainsbury,* 119 F. 2d 995, (10th Cir. 1940). It should also

be noted that the Uniform Declaratory Judgment Act, Sec. 4 states:

> "Any person interested as . . . trustee . . . may have a declaration of right or legal relations in respect thereto:
>
> (a) . . .
>
> (b) To direct the . . . trustee to do or abstain from doing any particular act in their fiduciary capacity; or
>
> (c) To determine any question arising in the administration of the estate or trust, including questions of construction of wills or other writing." 9 Uniform Laws Annotated (1951) at 232.

Under the Uniform Declaratory Judgment Act, the trustee in bankruptcy is specifically authorized to bring this type of action.

The Advisory Committee's Note to Rule 57, Federal Rules of Civil Procedure, states:

> "The Uniform Declaratory Judgment Act affords a guide to the scope and function of the federal act."

B. The Court of Appeals erred in finding that the trustee did not have standing to bring an action to enforce payment of the students creditors' claims. The Court determined whether a right of action passed to the trustee as part of the property of the bankrupt under Section 70 (a) and (b) of the Bankruptcy Act [11 U.S.C., Sec. 110 (a) and (b)], by ruling what right of action could have been maintained by the bankrupt at the time of bankruptcy. The Court completed its analysis by determining that under the language of the policy of insurance, the student creditors held the "beneficial property right in a liability policy when the terms of the policy give the injured party a right

of action against the insured." In reaching this decision, the Court of Appeals relied only on case law from the Sixth Circuit. [*In re Fay Stocking Co.*, 95 F. 2d 961 (6th Cir. 1938)]

In *Fay Stocking*, 95 F. 2d 961, however, the creditor had obtained a judgment against the bankrupt *before* bankruptcy was declared and therefore was entitled in its own right, to proceed against the insurer. That is not the case with the student creditors of World Academy. Not only did they not have judgments, they didn't even have a cause of action until the filing of the bankruptcy. Their claims arose at and after the act of filing bankruptcy and the subsequent failure to perform on the part of the of the bankrupt. Furthermore, as a practical matter, the creditors are prevented from obtaining a judgment in this case by a series of restraining orders, and are prohibited from proceeding against the estate of the bankrupt by any other than the claim method. The student creditors, therefore, had no beneficial interest in the insurance policy at the time of the bankruptcy either under the terms of the policy or under Ohio law. The insurance contract is held to be for the benefit of the insured and not someone whom he injures. *Chitlik* v. *Allstate Ins. Co.*, 30 Ohio App. 2d 193, 299 N.E. 2d 295 (1973).

The question which the Court should have been discussing and the question which the Complaint filed in the action asks is, "If the Court finds the claims of the student creditors are valid and if the claims are approved, can the trustee recover the amount of the allowed claims from the insurance company?" Phrased in this manner, the questions posed by the Court of Appeals regarding rights of action at the time of bankruptcy and the trustee's representation of

the creditors versus the bankrupt become meaningless. There was no right of action in anyone against the insurance company at the date of bankruptcy. This lawsuit arises out of the administration of the estate of the bankrupt by the trustee. If we were dealing with claims and rights of action which existed *prior* to bankruptcy, then the Court's decision concerning what actions the bankrupt could have brought would have some relevancy. Those, however, are not the facts of this case. Furthermore, any funds which could be recovered from the insurance company would certainly benefit both the bankrupt and the creditors and, therefore, that question becomes irrelevant. Should the Court find that it is within the ambit of the trustee to pursue the payment of these claims by the insurance company as a function of his administration of the estate of the bankrupt, representing the creditors, then the entire question of standing becomes moot, and we are faced with only the question of policy coverage. The Court of Appeals' ruling of lack of standing should be overruled and the case remanded to that court for a decision on the real issue of the case regarding coverage of the policy.

Lastly, the decision of the Court of Appeals has the practical effect of forcing 4,000 student creditors to individually litigate the question of coverage of the insurance policy issued to the bankrupt (after restraining orders and other obstacles are eventually removed). This will undoubtedly result in a great number of lawsuits and unequal recoveries by the individual creditors in those lawsuits, in direct contradiction of the policy and purpose of the Bankruptcy Act to secure an equitable, just, expeditious and economical distribution of the assets of the bankrupt among his creditors. See *Straton* v. *New, W. Va.*, 283 U.S. 318.

The holding of the case thwarts the purposes of both the

Federal Declaratory Judgment Act and the Bankruptcy Act and is a dangerous precedent under both. It is, therefore, a case of great general interest.

Respectfully submitted,

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November, 1975

APPENDIX "A"

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

Civil Action No. 7899

JAMES CISSELL, Trustee,

Plaintiff,

v.

AMERICAN HOME ASSURANCE COMPANY,

Defendant.

FINDINGS AND CONCLUSIONS

(Filed September 25, 1974)

This is an action by the plaintiff, the Trustee in Bankruptcy of an Ohio corporation named World Academy, Inc., against the defendant, American Home Assurance Company, on an insurance policy issued in February, 1970, to World Academy. Actually, what was known as World Academy was a composite of various subsidiary and affiliate companies, and that is true also of the named insured on the policy involved. Outside of the fact that the going concern (s) paid no practical or legal attention to various corporate entities and the purposes thereof — which may have some relevance to one issue in this case — it makes for clarity to simply disregard this multi-corporate setup and/or multiple-named insured. That will be done and the composite multiple will be referred to simply as World Academy.

Basically the complaint as filed was for a declaratory judgment determining not only certain substantive questions, but also certain procedural questions — in its latter aspect the action basically was one by a court-appointed officer, seeking instructions for that officer in a quandary.

There are and were multiple issues in this case. It would not hurt to set them down at this point before getting into the detail. Those issues could succinctly be described as follows:

1) The appropriate construction to be given the language of the insurance policy in question and/or the closely related question of whether the acts claimed to have caused the plaintiff's loss are covered by or insured against by the policy.

2) Whether the plaintiff as a bankruptcy trustee has standing to assert the claim which he does and the related question of the presence or absence of jurisdictional amount. It is conceded that this Court's jurisdiction is based solely on diversity and the diversity requisites, except for the possibility of amount, are otherwise present.

3) Whether, under the circumstances of this case, the allowance of a claim or a number of claims by a referee in bankruptcy is equivalent to a "judgment against" World Academy and/or the related question of whether, under the pertinent policy provisions, the requirement in the policy of a "judgment against" World Academy antecedent to an "action" against the insurer should be disregarded.

4) Whether plaintiff's settlement with and release of the officers and directors of World Academy initially and primarily responsible for the acts which plaintiff claims caused the loss and which plaintiff claims are covered — whether such settlement and release releases the defendant either on a theory of primary secondary liability or on a

basis of equitable estoppel, or on a basis of subrogation interference.

5) Whether the circumstances under which the policy was obtained constituted such fraud and misrepresentation that the policy should be rescinded. The premium paid has been tendered back.

Now to the detail. World Academy was born in 1966, ascended like a sky rocket, and fizzed into a bankruptcy appropriately on the weekend of July 4, 1970. It started out as a moonlight effort by two people. The idea was that during the summer of 1967 and subsequent summers, it would accommodate the desires of teachers to go to Europe for nothing and the desires of students to go to Europe for approximately a month and a half in the summer and combine travel and education — their efforts in the latter respect ideally to be accredited to their domestic educational requirements. Obviously this takes a lot of doing and the doing is in divided fields. One field might be described as the determination of the product and the necessary arrangements therefor. This required dealing with educators both in the United States and abroad from what might be called an academie point of view. Obviously, this did not include travel arrangements or have anything to do with travel, but it was a necessary function. The next major field that would have to be tackled would be the determination of what the product was going to sell for. Since the idea basically involved taking students to Europe and taking them through selected parts of Europe and exposing them to education during some of the travel, this involved negotiation for travel, lodging, housing, flying, busing, etc. Obviously, this function of the World Academy had a lot to do with travel.

Having determined what your product was and at about what you were going to sell it for, the next problem, of

course, was how you were going to market it. For purposes of this case, World Academy dealt with teachers and furnished the teachers an instructional brochure which is quite imposing. If a teacher succeeded in selling the product to eight students, the teacher went along free as an adviser. For purposes of this case, the cost to the student can be rounded out at approximately $1 000.00. If the teacher got less than eight, it cost him or her some money depending upon the number; and if he or she got more than eight, a stipend was added, so that if a given teacher, for instance, got fifteen, the teacher received approximately $350.00 in addition to the adviser-free trip. The teachers could be regarded as the salesmen and the teachers were furnished with, among other things, another and smaller brochure designed to be given to the students to interest them. That likewise in its final form is very imposing. For that matter, it is stated in this record that the cost of this brochure material both studentwise and teacherwise obtained for the year 1970 was more than a half million dollars. As it turned out it was quite excessive, i.e., more than needed. Be that as it may, it is important from the point of view of this case to remember just what was being sold. In one of the brochures the program philosophy of the company was thus stated: "Our objective in traveling should be, not to gratify curiosity and seek temporary amusement, but to learn and venerate, to improve the understanding and the heart." In other words, this organization was not selling travel, it was not selling education; it was selling them both.

As stated above, the selling was predominately, if not solely, through teachers. The students were given an application form, filled it in, paid an application fee ($25 or $30) and sent in that application through the teacher involved. In the form the student selected the particular course desired. The courses, to take a few examples, bore

such titles as "History of Religions and Modern Israel," "Russian and Eastern European Politics and Policies," "Ancient and Medieval Art." The standard time involved was 40 days and, as a rule of thumb, approximately three plus weeks were spent at one place, e.g., "new modern schools in the Parisian suburbs" for the purpose of accomplishing the educational part of it. The remaining approximately fifty percent of the time was occupied with travel, using air, bus, and rail. The music division, to take an example, went to Paris and on to Versailles, Strasbourg, Heidelbert, Munich, Vienna, Venice, and then back to New York. The student was expected to pay on a schedule, with full payment being due before departure date, and received various communications direct from the World Academy once he or she signed up. The student's instructions with respect to the exact departure date and location came from the teacher. Nobody ever issued a student a ticket for anything. The travel and lodging were all done on a group basis, involving charter with respect to air travel. The departures airwise were from New York.

To do all this, of course, required another function having to do with the overall operation and that could be succinctly described as administrative — again, this administrative performance or function cannot be classified as either in the travel or the educational field. It has to do with both, but no more becomes a part of either than does an army administrator become a combat soldier.

So much for the functions of this company broadly speaking and certainly over-simplified.

In 1967, as the result of moonlighting only, this company signed up and took to Europe 500 students. The first planeload was supposed to leave New York on a given date in 1967 with some 90 plus. As the plane was being loaded, the federal authorities informed all concerned that the

plane would not be permitted to depart because of lack of some United States certification. One of the company officials who testified in this case said quite frankly, "A representative announced that the plane would not take off, that they had not filed the proper papers for them to leave the New York airport. Well, I guess that is a mistake on my part, I should have been more thorough in analyzing this man's (the charter airline) position in checking it up." To make a long story short – and it is a long one, but an interesting one – the company succeeded in performing its commitment to these 1967 students via scheduled airlines, but it cost the company $150,000.00 to do that. The incident points up a couple of things relevant to this case and one of them is this: A concern like World Academy, operating an educational travel program in Europe with nonscheduled or charter airlines, has to pay its cost of producing its product almost in a unique way. At least 60 days before the first student gets on an airplane, it has to have paid the charter fee for that plane both going over and coming back. In addition to that, it similarly has to pay, although not so far in advance, the freight insofar as all the European installations are concerned, i.e., the schools, the hotels, the boarding houses, the convents, the bus lines, the rail lines, etc. So, if something happens that a given purveyor, be it airline or no, defaults, the travel school company has no alternative but to pay the extra freight if it can, or go into bankruptcy if it cannot.

In 1968 the European representatives of this company learned, after a charter aircraft bound from New York to Rome had taken off, that the Italian government was not going to permit the airline to land its craft in Italy. The diversion was to be to Greece. This difficulty likewise was overcome, but it is obvious that a diversion of a full DC-8 from one country to another would have cost the

responsible company a pretty penny and that, of course, gave this company food for thought too.

In 1968 World Academy signed up and took to Europe on this tour plan some 900 students. By 1969 that had grown to 2,000. By 1970 5,000 had signed up. That was 20,000 less than some of the optimists connected with the company forecast in 1969, and just one-half what the realists for the company forecast for that year. Of that 5,000, something in excess of 2,000 never left home; so at least something in the neighborhood of two million dollars went totally down the drain.

To leave World Academy for a while and focus on the defendant – during the 1960's the American population explosion led obviously to more travel and obviously more travel agents and, perhaps less obviously, to certain nightmares for the travel agents. The facts we deal with now were considered pertinent to this case, since all of them were called to the attention of World Academy by the defendant in connection with the issue of the policy that we will come to. There was no such thing as a liability policy covering the particularly special needs of a travel agent. For example, claims were being made against travel agents by persons to whom such agents had issued tickets for injuries suffered in foreign lands through the negligence of foreign bus drivers, or for the failure of a foreign establishment to live up to its brochure commitments. Clients stranded in out-of-the-way places because of strikes or civil disorders, etc., made claims against the travel agent involved. We are told, and there is no reason to disbelieve it, that there never was a comprehensive specially designed travel agent's policy written until 1968 and that this is the first case involving such a policy as issued to a travel agent which really is not a travel agent as such. Certainly one is going to look at the law books in vain for a case involving

a policy such as is involved here and that accounts for the lack of citation of authority herein.

A New York underwriting firm associated with the defendant American Home Assurance Company undertook to do the underwriting wherewithal to its offering. That was done and what resulted was the policy involved in this case. The issue of the policy was generally preceded by the delivery of a "kit" to the prospective insured. That was done in this case. The following quotations are taken from this kit:

> . . . . The policy is an unusually broad one, providing legal liability protection for claims involving bodily injury, personal injuries and property damage arising out of the operation of the travel agency including the acts of independent contractors, acting in behalf of the travel agency, anywhere in the world.

———

The policy covers not only the named insured travel agency, but also the officers, partners and employees of the agency against such claims as . . . .

———

Another feature of the Travel Agents Liability Policy is the coverage offered under its "errors and omissions" section. This part of the policy provides the additional insurance protection needed to cope with claims for damages made by a client when he alleges financial loss, inconvenience, embarrassment or other similar injury to be the fault of the agent because of what he believes to have been a mistake in the planning of his trip.

To keep the premiums at an economical level and also to keep the travel agent on his toes, the policy does not cover the first $250 of errors and omissions. In view of the magnitude of recent law suits, the $250 is a reasonable deductible.

———

Another factor worth considering, is that the travel agent is dependent upon the faithful performance of many others whom he has little or not control. Their failure to provide the proper facilities, in the eyes of the public, is often misinterpreted as failure on the part of the travel agent. With people traveling to more and more distant lands, the perils facing the travel agent have become greater than ever before. Consequently, as a merchant of dreams, the travel agent must be constantly alert and protected against the possible nightmare of his clients, whether real or fanciful.

———

The combination of a status of professional counsel, plus a reliance upon others to fulfill commitments which you made, is what creates a unique and ever-present insurable risk in your business; a specialized exposure to loss requiring specialized attention.

———

The errors and omissions liability covers claims for damages made by a client when he alleges financial loss, inconvenience or other similar injury to be the fault of the travel agent because of alleged mistakes in the planning of his trip or inadequate performance by others charged with providing services on the trip or tour. Deductible — $250 each claim.

———

. . . . coverage under the policy is limited to the insurance of the business of a Travel Agency only . . . .

The policy is in two sections . . . .

The "Errors and Omissions" section of the policy provides the additional insurance protection needed to cover claims for damages made by a client when he alleges financial loss, inconvenience, embarrassment or other similar injury to be the fault of the Travel Agent because of what he believes to have been a mistake in the planning of his trip or because of real or fancied inadequate performance by others charged

with providing the services expected of them during a trip or tour.

———

Coverage is world-wide . . . . and applies (in addition to any partner, executive officer, director or stockholder while acting in the scope of his duties as such) to any employee acting in the scope of his duties and to a tour conductor for liability . . . .

Exclusions are few, being limited to . . . . the inability or failure to collect any money whether by the insured or others. It is not the purpose of this policy to serve as indemnity for dishonest or criminal acts, nor as a fidelity or other type of bond guaranteeing the solvency of any party to travel arrangements . . . .

———

Further, since this section does, in effect, put the company in the position of backing the ability of the Travel Agent, and those through whom he provides services, to deliver those services as called for, it is felt that the Agent must also have some stake in the cost of his errors and those of others upon whom he is willing to rely. For this reason, as well as to keep the premium charge at a reasonable level, the first $250 of any claim is to be borne by the Travel Agent.

———

. . . . as in few other businesses a travel agent is dependent, after he has been paid for his services, upon the faithful performance of their duties by many others over whom he has little or no control if his obligations to his clients are to be discharged.

The combination of a status of professional counsel, plus a reliance upon others to fulfill commitments which you make, is what creates a unique and ever-present insurable risk in your business; a specialized exposure to loss requiring specialized attention.

———

In late 1969 World Academy was dealing with what is regarded as an unsophisticated insurance agency. It invited a solicitor, known to its managament, of what was regarded as a sophisticated agency, the Auburn Insurance Agency, Inc., of Cincinnati, to examine its present coverage and recommend additional coverages which it should have. As a part of the conversations between the agency representative, a Mr. Schwertman, and an executive of World Academy, the latter, who undoubtedly mentioned the unfortunate 1967 incident involving the grounded aircraft —

> ". . . . told him (Schwertman) that I had to insure that this program was performed and that I wanted an umbrella policy or an all-inclusive coverage policy or whatever he wanted to call it; but, regardless of what happened, I had to have this program perform.
>
> "In other words, what the performance is, taking the student there, instructing him, overseeing his travel and getting him home safely; and over and above all other insurance policies that we had in force or that we had discussed, I had to have that kind of coverage.
>
> "And one of the major reasons was that, for the first time, this had come out in print from our major competitor; and Trans-America, of course, has their own insurance company and they are writing this kind of coverage. But we also were getting of size and substance enough to merit it ourselves."

At that point, the World Academy executive —

> ". . . . suggested to him, from a friend of mine who was in the travel agency business, that he look into a travel agent's policy because of the conversation that I had had with a friend of mine who owned a business like that . . . .
>
> "World Academy wanted something that would insure the delivery of a package they were selling. . . .

"I just wanted to make sure that they got over there and got back; and that anything that might happen that would destroy our ability to pay or cause an increased amount of money that would have to be paid, that the young people would have the program delivered and brought home. . . .

". . . . The program demanded that we pay moneys in advance. If during delivery of the program something happened, an additional cost was required, we didn't have the funds to pay it. . . .

"I just wanted to make sure that the people had a place to stay and eat without — and do this off of the insurance policy. . . ."

Schwertman eventually dug up the underwriting firm that was connected with the defendant and obtained a travel agency policy kit from American Home, which included a sample policy and an application, etc. This was delivered to World Academy as the type of policy which fit the bill — actually it was what they asked for. The official of World Academy examined it and thereupon filled out an application and sent it in.

At the trial of this case, evidence was admitted of the conversations between Schwertman and the World Academy people and that evidence has been considered by this Court in arriving at its conclusions In addition, evidence was admitted which included the conversations between Schwertman and the representatives of the underwriting firm with whom Schwertman dealt (Waddell and Croker). There is nothing relevant and competent in the latter and that evidence has not been considered by this Court in arriving at its conclusions.

The application form was a standard form. It contained a number of questions. None of the questions were pertinent to the financial position of World Academy, with one exception. There was a question asking for the total gross

receipts the previous year and for the expected receipts for the next year. This application was signed early in January of 1970. $1,800,000 was given as the 1969 receipts and $8- to $10,000,000 given as the expected 1970 gross. Neither was a false representation. In fact, everything on the application was answered correctly. The form did contain this paragraph:

> We declare that the above statements and particulars are true and that we have not suppressed or misstated any material facts and we agree that this application shall be the basis of the contract with the Insurance Company.

The policy issued in due course, i.e., about the middle of February, and covered the period February 16, 1970, through February 16, 1971. It was entitled "Tarvel Agents' Professional Liability Policy."

The word "liability" is, we think, important. It did not purport to be a surety bond or a performance bond, or a fidelity bond, or a director or officer misfeasance bond or policy. It contained three separate coverages. The first was bodily injury and property damage; the second was professional errors and omissions; the third was personal injury. We are interested, of course, only in the second. The limit of liability in each instance was $3,000,000 and the overall premium was approximately $5,000. As a business proposition the premium is related to expected gross, reduced to a realistic figure of exposure. For example, based on its own figures contained in the application, the expected gross for 1970 was $8- to $10,000,000. Since the premium was related to that (and adjusted in proportion, based on actual experience) it was "knocked off" as a desirable $3,000,000 coverage, taking into consideration both the cost and the realistic exposure.

To return to the policy – the insuring agreement read:

> In consideration of the payment of the premium, in reliance upon the statements in the declarations made a part hereof . . . . agrees as follows:
>
> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of:
>
> * * *
>
> Coverage B – any negligent act, error or omission of the insured or any other person for whose acts the insured is legally liable in the conduct of travel agency operations by the named insured. . . .

There is one exclusion of pertinence and that is Exclusion (p) which recites this:

> (p) under Coverage B, to any liability arising out of or contributed to by . . . . the inability or failure to pay or collect any money whether such . . . . inability or failure be on the part of the insured or otherwise . . . .

In the definitions, "travel agency operations" is defined as follows: "means all operations necessary or incidental to the conduct of the travel agency business." That is like saying east is east, and for that reason led to the admission of expert testimony on just what a travel agency as such does. We will come back to that.

Going further with the policy, under it "the insured" includes not only the company as such, but also "any executive officer, director or stockholder thereof while acting within the scope of his duties as such; and any employee of the named insured while acting within the scope of his duties as such, and any tour conductor under contract to the named insured but only with respect to liability arising out of the tour being conducted for the named insured."

Finally, insofar as the policy provisions are concerned, there is this one dealing with "Action Against Company." It provides:

> No action shall lie against the company unless, as a condition precedent thereto, * * * the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.
>
> Any person who has secured such judgment or written agreement shall thereafter be entitled to recover under this policy. * * * No person shall have any right under this policy to join the company as a party to any action against the insured. * * * Bankruptcy or insolvency of the insured shall not relieve the company of any of its obligation hereunder.

Strangely enough, the policy was accepted without a word as apparently filling the bill. There is really not one word in it which guarantees to World Academy that those with whom it made contracts would perform, which is what it wanted. It is true that it stands behind the negligent act or omission or error of its insured, but that is about as close as it comes to what was desired. Stranger still, the company itself, i.e., World Academy, in reliance on this policy, appears to have encouraged its representatives to sell its package on the theory that because of this policy, American Home stood behind the performance by all concerned, all without any regard to the generally accepted concept of negligence.

By June of 1970, as has been mentioned, something in the neighborhood of 5,000 students had been signed up to participate in the Summer 1970 World Academy Travel Courses. That would indicate a gross intake of some $4,000,000. During the previous summer, a large Wisconsin combination, including such names as Northern Trust

Company, Northwestern National Insurance Company, etc., invested some $2,000,000 in stock of this company. On the surface, then, everything did look lovely. However, the surface did not tell the story and, for one reason or another, World Academy was broke. Of course, a great deal of this money involved had been prepaid to airlines, etc., to carry out the summer program, but certainly far from all of it. At the very most, in the neighborhood of 2,000 many have left the country on the 1970 program and some 2- to 3,000 never left their homes. The company went bankrupt in early July of 1970 and, while this record is not clear, a substantial number of students in Europe at the time were cut short and returned home. Typical claimants testified in this case, i.e., claimants who, as ex-students or would-be students, had filed claims in the bankruptcy against World Academy. One left New York on June 28 on what was to be a 40-day study trip concentrating in Paris. By the 7th of July, the group, of which she was a part, was informed that World Academy had collapsed and they were placed on their own. For practical purposes, about the only thing that was done with that group that was supposed to have been done was that they were taken over and brought back after being over there a couple of weeks on their own. Another witness was supposed to have left on June 28th – the trip was postponed until July 7th and on July 4th the student was informed that there would be no performance at all. Another, who had paid approximately $1,000, left on June 28th, was brought back about 4½ weeks early and was stranded on her own during the time over there. Another was the parent of a student who was supposed to leave on the 7th of July and, of course, never left. The record contains a reference of a planeload (at least 180) ready to take off from some California airport on July 2nd and meeting with a cancellation at that time.

While the record contains descriptions of twice the hotel capacity showing up in a European city at the same time, there is no causation evidence in this record of anything other than that the company was broke. By that we mean that the various losses which constituted the claims of the students filed in the bankruptcy – with one possible exception – are not related in this record and cannot be related to any negligence in making or confirming a reservation and/or in picking an unsuitable place, etc. As we say, except for one. The only causation evidence is that the company was broke, could no longer perform, and its various contractees – except for the airline involved – knew of the insolvency situation and simply canceled or quit cold, without regard to whether they had been paid or not. Evidently the airline involved had been paid sufficiently to cover the transportation home for everybody who was over there at the time of the bankruptcy – at least in fact the airline brought them home by re-arranging its schedules, etc. The one possible exception that has been referred to above is this – when this company went into bankruptcy, it still had something between $2- and $300,000.00 in cash – at least its bank account had that much in it, although we are not told what the outstanding checks were. There is some claim that it was negligence not to use this money for the benefit of the students then in Europe. In this Court's view, the ordinary principles of preference would prohibit that. However harsh the application of the word to this situation, it simply would have been a preference to prefer some of the 4- or 5,000 who had signed up over the others and recognition of that certainly is no negligence.

In any event there have been thousands of claims filed by students in the bankruptcy and the aggregate amount of the claims exceeds $2,300,000. In addition, there is evidence in this record of one claim, as a typical claim, which involves

this — according to this record it is difficult for any American entity to make travel and lodging arrangements directly in a number of countries in Europe. One must go through a European travel agency. World Academy dealt with a number of them. The typical we will abbreviate as "Sport of Italy," with a claim for some $514,000.00 for commissions due in 1969 and 1970 as the general agent in Europe, for expenses advanced to European installations, and for penalties and forfeitures. Once again, if this be a valid claim, to the extent it is the damage which brought it about cannot be related to anything directly except the fact that World Academy went broke.

After the bankruptcy and prior to the first meeting of creditors, there was sent to every creditor, including the type with which we deal here, a formal notice of the filing of the bankruptcy. This notice notified all creditors that their "claims should be mailed to the referee in bankruptcy" at Cincinnati. It enclosed claims forms for the use of each creditor and it dealt specifically with the students' claims in this manner:

> In the case of claims filed by students or on behalf of students, attach a statement giving the name and address of the student and the parents or guardian, and other information, such as flight number, canceled checks, etc.

Later on, on the trustee's motion, the bankruptcy judge granted orders enjoining any and all creditors from filing or proceeding further in any litigation to establish claims against World Academy except by claim filed in the Bankruptcy Court in the Southern District of Ohio. The order was signed in November of 1970. There has been no application made by anybody to the bankruptcy judge to dissolve that injunction as against any creditor. In fact, late in November 1970, there was distributed to all of the

creditors, including the student creditors, a notice reminding them that February 12, 1971 was the last date for filing claims. That notice stated in part this:

> Another matter of interest to the creditors is the work being done in connection with a "Travel Agents' Professional Liability Policy" which was issued to World Academy. This policy has Limits of Liability of $3,000,000.00.
>
> The insurance policy contains an agreement to pay damages caused by any negligent act, error or omission of World Academy in the conduct of travel agency operations. The Trustee has, through his attorney, been working with the insurance company which issued the policy with reference to the alleged negligent management of the Companies and a claim for payment under the terms of the Policy.

One action filed in 1970 in California against World Academy by student creditors was terminated as a result of the injunction order above described.

In the sense in which the word is commonly used, no creditor of World Academy has obtained a judgment against it. The trustee has not presented the student claims or any other claims to the bankruptcy judge for allowance or disallowance by reason of an apprehension that that course might procedurally block the assertion of the claims in the aggregate against the defendant. The trustee in effect is asking this Court in advance for a declaratory judgment to the effect that the presentment of at least the student claims and the allowance by the bankruptcy judge will constitute the equivalency of a judgment against World Academy as that term is used in the policy.

As intimated above, since the bankruptcy, and specifically in October of 1970, the trustee set forth a claim against the defendant on its proof of loss form for approximately $2,350,000.00 and made demand for the payment of it.

This part of the claim basically represents the students' claims in the aggregate. The claim was amended in November of 1970 so as to be increased by approximately $775,000.00 by including the claims of creditors, such as "Sport of Italy." The claim is described as follows, under the heading of "Describe the circumstances as fully as possible" in the claim form:

> "Negligence of corporate officers and principals, flagrant mismanagement, careless use of funds; used up resources so insured could not perform. The negligent acts, errors and omissions of the insured rendered it unable to conduct operations necessary or incidental to the travel agency business."

That is about as succintly as the plaintiff's claim could be put. In other words, no direct relationship of cause and effect is claimed between any item of damage and any stated insured – against act.

The defendant insurance company not only rejected the claim promptly, but went further and asserted that the policy was issued as the result of fraud or misrepresentation and tendered back the premium which had been paid. This tender-back preceded the filing by the trustee of the complaints against the officers and directors hereinafter referred to.

Before departing from what might be called the coverage question in this case, several things. The first is our "east is east" problem. The record contains expert testimony on what travel agencies do. This under the heading of this Court is far from sure whether a court knows such as a matter of judicial notice. One thing that can be said with certainty is that travel agencies, as such, do not provide campuses, do not organize campuses, do not enter into specifying and providing the wherewithal of instructing in history or in political science, or in art and art history, or

in literature and dramatic arts, or in music, or in foreign languages. Nor do travel agencies deal with the academia in respect of questions affecting curricula and educational certification.

There are three general types of travel agencies. One type deals strictly with individuals, does not purport in any way to regulate or guide the customer during travel except as a matter of advice and providing the tickets for the necessary monetary consideration. It is a counseling and ticket office, specializing in the travel field. Again, dealing in the broadest generalities, this type, as well as the other types, may or may not be regarded as substantial. If they are, chances are they belong to some domestic or international association and have direct contractual relationships with carriers, etc., authorizing the issue by the agent of usable tickets, reservations, etc. These associations generally require bonds for membership. Their bonds do not deal so much with the performance of the obligations set forth in the tickets as they do with the fidelity of the travel agent in handling money, from the point of view of both the customer and the carrier. Then there are wholesale travel agencies which differ from the retail just like any other wholesaler. They will put together the results of the various retailers in a package for price purposes. Then, there are tourist agencies which do about what the retail agency will do except that they will provide, in addition, supervision during the actual travel. By and large, in such a set-up, the traveler will not be ticketed. He will go around as part of a group at least basically under the shepherding of the tour bureau and the tour bureau will be the one that has the tickets and about all the traveler will have is information.

All travel bureaus certainly have this in common – they sell a product, take a person's money, pay somebody

else to do what they have sold, and do very little of it themselves. That is the nature of the animal. This dependence on performance by others is the big risk in a travel agency. Anyone in such an operation obviously would be held to the standard of ordinary travel agency care in its selection of the persons to do what it is selling and that may or may not cover an awful lot of territory. However broad the territory, it would certainly be nice, as the saying goes, to have a built-in defense and/or insurance against the cost of defense of the various claims that a fertile mind could come up with. Such a simple thing as forgetting the effect of crossing a date line would intrigue the imagination of a claimant.

There are obviously untold thousands of risks of mistakes in a travel agency operation different from the risks in other businesses — all of which has something to do with the meaning of "Travel Agent's Professional Liability Policy." Just as obviously a number of the activities of World Academy were appropriately and could appropriately be described as operations necessary or incidental to the conduct of a travel agency business.

Secondly, there is in this record expert testimony, including the testimony of what might be called the father of this policy, on the meaning of its various terms. That testimony has been accepted by this Court for expert purposes only, with exactly the same effect as in patent cases expert patent counsel are permitted to similarly testify. In other words, it is an educational or background help, but not fact-basis testimony as such.

Still in the coverage area, and pursuant to a pretrial order, the plaintiff designated in the record the items and occurrences which are claimed, individually and collectively, to constitute the "negligent acts, errors or omissions

of the insured" within the meaning of the policy in question. The designated acts include the foolish spending of the $2,000,000 invested by the Wisconsin investors in the summer of 1969; the development of enormous overhead and unproductive marketing and selling expenses; mismanagement; the discharge of the sales force in March of 1970; a departure from businesslike methods such as the failure to inventory furnishings, the disbursement of cash without records, the employment of company agents without definition of duty, paying exorbitant advance commissions to sales force, loaning excessive amouts to officers and employees and/or failure to try to collect; ineffective use of funds, for instance, the payment of a large liability endorsed by at least one corporate officer; inept, disorganized and ill-considered handling of corporate funds; and perhaps certain others. The issue in this case of whether those alleged, designated negligent acts occurred or not was severed. It may be that that issue will have to be tried in the future. It must therefore be presumed for the purposes of this present bifurcated trial that the designated acts did occur and that they are appropriately described as negligent ones.

To return to the chronology — in 1971 the trustee filed two lawsuits against the directors and officers of World Academy. One was in this Court and one was in the Court of Common Pleas of Hamilton County, Ohio. Essentially these cases collectively and with some repetition made various charges of mismanagement, unfair dealing, breaches of fiduciary relationship, violation of securities laws, etc., resulting in, as claimed, some two and one half to three million dollars damage by the World Academy.

For the purposes of this case, this is true — the acts designated in this record as the negligent acts within the terms of the insurance policy and the acts which furnished

the basis of the claimants set forth in the two cases filed by the trustee are the same. In 1974, for all practical purposes; or to say it another way, for purposes of this case, the claims of the trustee set forth in those two cases were settled with the bankruptcy judge and as a part of the settlement (which settlement involved a relatively substantial sum) the various officers and directors and employees, who were credited or charged with doing the various negligent acts, were released. That furnishes the basis for the defendant's defenses of release due to interference with subrogation, release of parties primarily liable, and release by reason of equitable estoppel. The policy does provide: "In the event of any payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefor against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights."

The facts relative to the counterclaim for rescission have generally been touched on. The claim really amounts more to a claim that relevant facts were suppressed rather than that any actual misrepresentation was made. The relevant facts that are claimed to have been suppressed are these (it is a fact they were not disclosed) :

(1) Some time during the previous year an investigation was initiated by the Ohio Securities Division involving sales of stock in violation of the Ohio securities laws by several of the top officers of World Academy. That was the fact and the investigation was ongoing at the time of the issuance of the policy and some substantial time subsequent to the failure of the company indictments were returned, which resulted in guilty pleas.

(2) Up to late 1969, the affairs of World Academy had

been audited by a local certified public accountant named Mary Hall. In April she had reported to the company that, as of March 31, 1969, the company in the three months' period preceding thereto had lost approximately $130,000. She also reported to the company, unaudited, that based on its own figures and for the six months' period ended June 30, 1969, it had suffered a loss of $301,000.00. In November of 1969 the auditor Hall had reported, based on an audit of the nine months' period ending September 30, 1969, that the company had lost in that period in excess of $1,000,000.00. As a matter of fact, the company never had made any money and that was well known to its officers, including the officer who dealt with Schwertman. Those are the facts with respect to its financial operation and condition.

(3) There had been a substantial shakeup in or just previous to December, 1969, in the top management of the company. That was the fact.[1]

(4) There are several matters which are difficult to categorize, from the point of view of the defendant's claims, under the heading of misrepresentation or suppression. We will deal with them in the following paragraph.

There is an indication that it was intimated to Schwertman that the company officers had declined an offer the previous spring — which started out as $6,000,000 and went to $15,000,000 — for the business of the company. There is an intimation that the company was in the process of going public and that knowledge of that was transmitted to Schwertman. There are similar intimations with respect to the employment of a national accounting firm in con-

[1] In December, 1969, the company had been unable, for awhile, to meet current, everyday obligations. That was not disclosed.

nection with going public and a law firm of national repute in the same connection. There are intimations that it was represented that the company expected 10,000 students to sign up. The difficulty with all of these things is that there was nothing false about them as far as this record shows. For what this record shows, maybe the company did have a $15,000,000 offer. After all, a seasoned investment firm, in the same summer, invested $2,000,000 for a part of the stock. The fact of the matter is that the company was in the process of at least thinking about going public and had employed the accounting firm and the law firm in that connection.

It is practically undisputed that the only thing the insurance agent Schwertman (and for purposes of this case, insofar as his dealings with World Academy are concerned, he was as a matter of Ohio law the agent of the defendant — Ohio Revised Code § 3929.27) actually asked for, outside of the accomplishment and execution of the application, was "financial information." He was told that the company had been audited by Mary Hall. He did not ask for copies of any of her audits. He was told that Peat, Marwick was in the process of auditing and that they would probably prefer that audit and it would be given to them when it became available. The fact of the matter is that Peat, Marwick was then auditing and its audit became available in March of 1970. It dealt specifically with the year ended September 30, 1969. It indicated a loss of $1,354,000 for that year. No one ever volunteered to give it to the defendant. The defendant never asked for it. This, coupled with the fact that the defendant under the policy had a cancellation right, almost forces the conclusion that not much reliance was placed on any financial situation or information or lack thereof.

Certainly no representation of anything financial was made by any officer of World Academy in connection with obtaining this policy. The company did present the appearance of an ongoing well-operating concern but that is neither misrepresentation nor suppression. It is true that the application contains the statement heretofore referred to, "We have not suppressed or misstated any material facts." But certainly the judge of materiality is not the purchaser of insurance, it is the seller; and one may well presume, as it is found in this case, that the material questions or the material facts were those dealt with in the application prepared by the seller, and it is certain that those questions were truthfully answered.

On the rescission issue, it is the conclusory finding of this Court that there was no fraud either by misrepresentation or suppression.

CONCLUSIONS

1) The defendant has failed to establish even by a preponderance of the evidence that the policy was obtained by fraud either in the misrepresentation sense or in the suppression sense. There was no relationship of confidence or trust between World Academy and the defendant. The dealings were at arm's length and there was no duty on the World Academy except to answer truthfully the questions propounded in the application and the questions propounded by Schwertman. Under the evidence in this case, World Academy so did. Further, Ohio law requires a showing of fraud by "clear and convincing" evidence.

It is clear that the insurer, on being told that an audit by a national firm was in process, was satisfied to await the result — no one ever asked for any previous local audit,

nor did anyone ever follow up to ask for the national audit. The insurer was simply satisfied to issue the policy *without* any financial information and continued satisfied to let it remain issued without such.

2) The acts of negligence designated by the plaintiff do not, either individually or collectively, constitute "negligent acts, errors or omissions of World Academy or any other person for whose acts the insured was legally responsible *in the conduct of travel agency operations.*"

It is true, of course, that the designated acts were, for purposes of this trial, acts of the agents, officers, and directors of World Academy for which the insured, World Academy, was legally liable – in the sense that the various acts designated were committed by the various individuals in the scope of their employment by World Academy. There is no problem with that part of the coverage. The problem arises on whether or not those designated acts constituted negligent acts, errors, or omissions in the conduct of the travel agency operations by the named insured. This Court concludes in the negative. That language means that in doing things peculiar to or generally done by travel agents, World Academy and its employees would exercise that degree of care and skill, whether from a commission or an omission point of view, as would be exercised by the ordinarily prudent travel agent under the same or similar circumstances. In other words, it is a liability policy. A policy which insured a lawyer against any negligent act, error or omission by him or his employees in the conduct of his law business would not insure that the lawyer or his forwarding counsel would be solvent. For instance, the coverage extended by this policy would clearly have taken care of the failure of a World Academy officer to check whether a given charterer had a license to charter,

or would clearly cover a mistake in booking a flight on a day the flight did not operate.

There is another reason for the conclusion against coverage. The policy specifically excludes any liability arising out of or contributed to by the inability or failure of World Academy to pay –

> "The policy does not apply to any liability arising out of or contributed to by the inability or failure to pay by World Academy." (Exclusion (p) paraphrased.)

That is exactly what happened here. All of the claims evidenced as typical claims in this case arose, not by reason of the negligence of somebody in contracting or performing, but by reason of the inability of the insured to pay, as evidenced by the facts in the record.

The plaintiff's argument is that the designated acts constituted negligent acts and that the negligence proximately caused the insolvency and the insolvency proximately caused the loss. Even if we agree with the first premise, the second appears to be clearly within the exclusion of the policy.

Finally, the policy is a liability policy insuring against "negligence." The term "negligence" from a legal point of view not only inately involves the concept of proximate cause but that concept is adopted in this policy. The agreement is to pay damages "because of" the negligence of the insured. There certainly is no proximate cause relationship in a legalistic sense – whatever may be the case in a syllogistic sense – between any one or more of the designated negligent acts and any of the typical claims in this case. The plaintiff concedes there is no specific relationship between any "designated act" and the loss of any particular student or group of students.

3) It is the conclusion of this Court, and may be so incorporated in a declaratory judgment, that, under the peculiar facts in this record and the language of this policy, the allowance of a claim by the bankruptcy judge is the equivalent of a judgment within the policy term, and that upon the allowance of the various student claims and to the extent thereof, the trustee has standing to assert a claim under the policy.

This policy contains two provisions which, as a practical matter, are inconsistent. It recognizes that a claim may be asserted by the insured based on a liability for a covered transaction established by a judgment against World Academy. In fact, it requires a judgment as the basis for the assertion of a claim against the insurer. On the other hand, it provides that the liability of the insured shall not be affected by the bankruptcy of the insured. As a practical matter, and as evidenced by the facts in this record, the requirement of a judgment against the insured and the survival of the bankruptcy of the liability of the insurer are inconsistent.

It is a matter of common knowledge that bankruptcy, as a matter of practicality, stops the assertion of claims against the bankrupt except in the form of a claim in the bankruptcy court. Under the provisions of 11 U.S.C. 2(a) 15, the trustee in this case obtained an injunction against any creditor of World Academy proceeding other than by the claim method. While the defendant points out that the injunction may have been issued without full compliance with the notice requirements of the civil rules, such an objection could only be made by one affected by it, i.e., a creditor. The injunction stood as a matter of fact and as a matter of law until dissolved. No effort has ever been made to dissolve it and it stands to this day. We are aware that there is a discretion in the bankruptcy judge

to dissolve that injunction and that that discretion has been frequently exercised in favor of a dissolution, on request, in cases involving insured liability, such as this case. See, for instance, cases cited in Collier on Bankruptcy, 14th Ed., 3.30 and 3.31. No such request was made by anyone in this case. It is therefore the conclusion of this Court that, under the peculiar facts as aforesaid, the allowance of a claim by a bankruptcy judge, upon finality, becames the equivalent of a "judgment against the insured."

The controlling purpose of the policy requirements of notice of claim, representation of the insured during legal proceedings, and a "judgment," is the prevention of false, fraudulent or spurious claims. That purpose is served by the claim process before a bankruptcy judge so long as the insurer has notice and an opportunity to object and contest. It is the "controlling purpose" that must be served in insurance policy construction — not the technical verbiage. See *State Farm Mutual* v. *Oliver*, 406 F. 2d 409 (6th Cir. 1969).

4) *Zahn* v. *International Paper* does not apply as the amount involved in this controversy exceeds $10,000.00. The defendant argues that the plaintiff in effect is asserting the claim of each student and in effect bringing several thousand different actions, none of which involves the requisite jurisdictional amount since no student claim would exceed approximately $1,000.00 and that therefore *Zahn* applies. The conclusion here is to the contrary. The plaintiff is asserting one claim under the policy in the amount of approximately three million dollars, containing thousands of items of damage. It is not a class action situation.

5) The release of the officers and directors did not effect a release of the defendant under any theory of primary secondary liability, or interference with subrogation, or equitable estoppel. There are two reasons for this conclusion.

The first is this: Prior to the time the World Academy made any attempt to collect against the individuals who are described by the defendant as primarily liable, the trustee asserted a claim against the defendant. That claim was rejected. A trustee in bankruptcy owes a peculiar obligation to effect collections overally in the best interest of creditors. Once a claim is asserted by such a trustee against an insurer and denied, the trustee need not wait or delay in prosecuting alternate methods of collecting until such time as the claim against the insurer is litigated out. Such a trustee is free to proceed directly with alternate methods of collection and credit same on any liability eventually established against the insured. Cf., *Bunge* v. *Insurance Co.*, 391 F. 2d 496 (2nd Cir. 1968) and cases cited at 497.

The second reason is this: Under the terms of the policy, as we have pointed out, the officers and directors and agents and employees of the World Academy, to the extent they made any covered errors or mistakes, are "named insureds." It would therefore seem to this Court that any proceeding by the insurer against its own named insureds would be running around the barn. As a matter of fact, the trustee by collecting directly has, it would seem, reduced the exposure of the insurer.

A judgment consistent herewith, dismissing the complaint, may be presented.

/s/ Timothy S. Hogan
United States District Judge

APPENDIX "B"

No. 75-1040 No. 75-1053

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

JAMES CISSELL, Trustee, *Plaintiff-Appellant,* v. AMERCAN HOME ASSURANCE COMPANY, *Defendant-Appellee.*	APPEAL *from the* United States District Court for the Southern District of Ohio, Western Division.

Decided and Filed September 9, 1975.

Before: MILLER and LIVELY, Circuit Judges, and O'SULLIVAN, Senior Circuit Judge.

MILLER, Circuit Judge. This action was instituted by a trustee in bankruptcy seeking performance of an insurance policy issued to World Academy, a now defunct travel agency organization. The complaint sought interpretation of the policy, a declaration of rights and obligations of the parties, and instructions to the trustee in bankruptcy as to the manner in which claims of student creditors (customers of World Academy) should be presented to the bankruptcy judge.

The district court tried the case without a jury and ruled

in favor of defendant on the claims of plaintiff but ruled in favor of plaintiff on certain claims and defenses of defendant raised by counterclaim.[1] Plaintiff's appeal generally raises the issue whether the district court erred in its interpretation of the insurance policy and in not submitting factual issues to a jury. On cross-appeal the defendant urges that the district court erred in finding: (1) that the plaintiff had standing to bring the action; (2) that the jurisdictional amount was present; and (3) that defendant was not discharged by virtue of the plaintiff's release of parties primarily liable.

In February 1970, defendant issued to World Academy a Travel Agents' Profesional Liability Policy which provided that "the [defendant] company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay because of: . . . any negligent act, error, or omission of the insured or any person for whose acts the insured is legally liable in the conduct of travel agency operations by the named insured . . ." The policy further provided that " 'travel agency operations' means all operations necessary or incidental to the conduct of the travel agency business . . . ." The policy also carried an exclusion which provided that the "policy does not apply: . . . (p) under Coverage B [the coverage quoted above] to any liability arising out of or contributed to by . . . the inability or failure to pay or collect any money whether such

[1] Specifically, the district court found that the policy in question had not been obtained by fraud, that the acts of negligence of World Academy were not acts covered by the policy, that the trustee had standing to bring the suit, that the amount in controversy requirement of $10,000 was met, and that the insurance company was not relieved of any duty to pay by the fact that there was an alleged release of bankrupt's former directors who might have been primarily liable. Accordingly, both the complaint and counterclaim were dismissed.

. . . inability or failure be on the part of the insured or otherwise."[2]

At the beginning of July 1970, World Academy had available cash of about $300,000 and total assets of about $2,000,000. Several thousand students had begun or were ready to begin their travel in Europe when the company management decided to file in bankruptcy. After the bankruptcy petition was filed all creditors were notified that their "claims should be mailed to the referee in bankruptcy." Forms were enclosed for use by the students in making their claims. Claims from the travel agency customers and others were filed in an amount exceeding $2,300,000. In October 1970, the trustee in bankruptcy, seeking to represent the student claimants, demanded that defendant pay the student claims under the provisions of its policy.[3] This demand was rejected on the basis of noncoverage.[4]

Upon the request of the district court, plaintiff filed a list of the occurrences or omissions upon which he relied as giving rise to the liability allegedly covered by the policy. For the purposes of its decision, the district court assumed that these events did occur, holding a bifurcated trial

[2] Testimony was heard, however, that World Academy had stated to defendant that it wanted a policy to guarantee performance in the sense of assuring that customers got to Europe and back on the tours planned by World Academy. Plaintiff attempted to show that this was the protection that World Academy thought it was purchasing.

[3] The student claims were amended in November 1970, increasing them by approximately $775,000. The increase represented the claims of other creditors, such as "Sport of Italy."

[4] Defendant further asserted that the policy was issued as a result of fraud or misrepresentation. It accordingly tendered back the premium which had been paid.

limited in the first instance to the meaning and construction of the policy language.

We first consider defendant's argument that the trustee has no standing to maintain the present suit. It is argued that although the trustee is appointed for the *benefit* of creditors, he represents the bankrupt and hence may not assert the claims of creditors against it.

To determine what property and rights of action pass to the trustee it is necessary to look first to the powers conferred by the Bankruptcy Act. 11 U.S.C. § 1 *et seq.* Upon his appointment, the trustee is vested with title to all the bankrupt's assets, embracing "property, including rights of action, which prior to the filing of the petition [the bankrupt] could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered" and "rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property." 11 U.S.C. § 110 (a).

As a creature of statute, the trustee in bankruptcy has only those powers conferred upon him by the Bankruptcy Act. *Imperial Assurance Co.* v. *Livingston,* 49 F. 2d 745 (8th Cir. 1931); *In re Freedman,* 168 F. Supp. 25 (E.D. Mich. 1958), *aff'd,* 272 F.2d 6 (6th Cir. 1959), *cert. denied,* 362 U.S. 950 (1960); *Fitzgerald* v. *Marshall,* 161 F. Supp. 470 (D. Colo. 1958); *Barnes* v. *Hirsch,* 212 N.Y.S. 536, 215 App. Div. 10 (1925), *aff'd per curiam,* 242 N.Y. 555 (1926). Under the statute the trustee steps into the shoes of the bankrupt and generally would have standing to bring any action which the bankrupt could have brought had it remained solvent. *Bayliss* v. *Rood,* 424 F.2d 142 (4th Cir. 1970); *Schueler* v. *Phoenix Assurance Co. of New York,* 223 F. Supp. 643 (E.D. Mich. 1963); *Barnes* v. *Hirsch,* 212

N.Y.S. 536, 215 App. Div. 10 (1925), *aff'd per curiam,* 242 N.Y. 555 (1926). A trustee may not sue upon claims not belonging to the estate even if they were assigned to him by creditors for convenience or other purposes. *In re Petroleum Corp. of America,* 417 F.2d 929 (8th Cir. 1969).

In ascertaining what cause of action the bankrupt in this case would have had against defendant, we must first consider the pertinent terms of the policy. It provides that "[n]o action shall lie against the company . . . until the amount of insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company." The policy further provides that "[a]ny person who has secured such judgment or written agreement shall thereafter be entitled to recover under this policy. . . . Bankruptcy or insolvency of the insured shall not relieve the company of any of its obligations hereunder."

Thus, the express language of the policy requires a judgment against the insured or a written agreement between the insured, the claimant and the insurance company, as a condition precedent to any action against the insurance company on the policy. No such judgment or written agreement has been obtained in this case.

Even if a judgment or written agreement had been obtained, plaintiff would have no standing to bring this action. The injured party rather than a trustee in bankruptcy has the beneficial property right in a liability policy where the terms of the policy give the injured party a right of action against the insurer after obtaining a judgment against the insured. *In re Fay Stocking Co.,* 95 F.2d 961 (6th Cir. 1938); *cf. Hanover Insurance Co.* v. *Tyco Industries, Inc.,* 500 F.2d 654 (3d Cir. 1974).

This case also is distinguishable from the line of cases holding that an insured has a cause of action against an insurer who, negligently or in bad faith, fails to settle a claim within the policy limits which failure results in a judgment in excess of the policy limits. *See Young* v. *American Casualty Co.*, 416 F.2d 906 (2d Cir. 1969), *cert. dismissed*, 396 U.S. 997 (1970); *Anderson* -. *St. Paul Mercury Indemnity Co.*, 340 F.2d 406 (7th Cir. 1965); *Moore* v. *United States Fidelity & Guaranty Co.*, 325 F.2d 972 (10th Cir. 1963); *Smith* v. *State Farm Mutual Automobile Ins. Co.*, 278 F. Supp. 405 (E.D. Tenn. 1967). In those cases the insured actually suffered an injury in being subjected to excess liability. Until the insured parties have been subjected to a loss, they cannot maintain a cause of action against the insurer. *See, e.g., State Automobile Insuance Co.* v. *York*, 104 F.2d 730 (4th Cir. 1939). The insured party here, World Academy, has not been subjected to any final adjudication of liability. Thus, at this stage of the proceedings in bankruptcy, the trustee must assume his statutory duty of objecting to any claims which may be improper rather than assume the role of an advocate of the parties asserting those claims. 11 U.S.C. § 75.

Neither is this case controlled by cases holding that a trustee in bankruptcy has standing to sue as a representative of creditors to avoid fradulent transfers. *See Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir. 1969). In *Buttrey* the trustee asserted creditors' rights to avoid corporate transactions between the bankrupt (a securities dealer) and another securities dealer on the theory that the transactions were in fraud of bankrupt's creditors. The defendant in that case argued that only the defrauded customers could maintain the action. The Court held that the bankruptcy trustee should be permitted to

maintain the action under Section 70 (e) of the Bankruptcy Act, 11 U.S.C. § 110 (e), which defines fraudulent transfers and specifically empowers the trustee in bankruptcy to avoid such transfers for the benefit of the bankrupt's estate.[5] It was noted that while, in a general sense, a trustee in bankruptcy stands in the shoes of the bankrupt, the Bankruptcy Act specifically vests a trustee with the right of creditors to avoid fraudulent conveyances. In the present case no such statutory right exists.

In the final analysis, whether a right of action exists in the trustee depends on whether the action vests in the trustee as an assignee for the benefit of creditors or, on the other hand, accrues to *specific* creditors. The latter is the case if the action is not in a fair sense an asset of the bankrupt which passes to the trustee. *In re Associated Oil Co.*, 289 F. 693 (6th Cir. 1923). The cause of action here sought to be asserted is for the benefit of specific creditors and is not properly maintainable by the trustee.

As the plaintiff lacked standing to sue, it is unnecessary to reach the other issues raised on appeal. The case is remanded to the district court for entry of a judgment dismissing plaintiff's complaint for the reasons herein stated and dismissing defendant's counterclaim without prejudice.

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[5] A similar provision, Section 60(b) of the Bankruptcy Act. 11 U.S.C. § 96(b), gives the bankruptcy court the option of preserving voidable preferences obtained by lien or security title for the benefit of the bankrupt's estate. The lien or security title preserved passes to the trustee in bankruptcy.

APPENDIX "C"

SECTION SEVENTY (11 U.S.C. § 110)

§ 70. Title to Property. a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trade-marks, and in applications therefor: *Provided,* That in case the trustee, within thirty days after appointment and qualification, does not notify the applicant for a patent, copyright, or trade-mark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted unless for cause shown by the trustee the court grants further time to the trustee for making such election; and such applicant may, in any event, at any time petition the court to be revested with such title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of

action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: *Provided,* That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process: *And provided further,* That when any bankrupt, who is a natural person, shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, excutory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this Act, be deemed to be held by the assignee

as the agent of the bankrdupt and shall be subject to the summary jurisdiction of the court.

All property, wherever located, except insofar as it is property which is held to be exeınpt, which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.

All property, whereve: located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy.

The title of the trustee shall not be affected by the prior possession of a receiver or other officer of any court.

b. The trustee shall asume or reject an executory contract, including an unexpired lease of real property, within sixty days after the adjudication or within thirty days after the qualification of the trustee, whichever is later, but the court may for cause shown extend or reduce the time. Any such contract or lease not assumed or rejected within that time shall be deemed to be rejected. If a trustee is not appointed, any such contract or lease shall be deemed to be rejected within thirty days after the date of the order directing that a trustee be not appointed. A trustee shall file, within sixty days after adjudication or within thirty days after he has qualified, whichever is later, unless the

court for cause shown extends or reduces the time, a statement under oath showing which, if any, of the contracts of the bankrupt are executory in whole or in part, including unexpired leases of real property, and which, if any, have been rejected by the trustee. Unless a lease of real property expressly otherwise provides, a rejection of the lease or of any covenant therein by the trustee of the lessor does not deprive the lessee of his estate. A general covenant or condition in a lease that it shall not be assigned shall not be construed to prevent the trustee from assuming the same at his election and subsequently assigning the same; but an express covenant that an assignment by operation of law or the bankruptcy of a sepcified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same is enforceable. A trustee who elects to assume a contract or lease of the bankrupt and who subsequently, with the approval of the court and upon such terms and conditions as the court may fix after hearing upon notice to the other party to the contract or lease, assigns the contract or lease to a third person, is not liable for breaches occurring after the assignment.

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee shall have as of the date of bankruptcy the rights and powers of: (1) a creditor who obtained a judgment against the bankrupt upon the date of bankruptcy, whether or not such a creditor exists, (2) a creditor who upon the date of bankruptcy obtained an execution returned unsatisfied against the bankrupt, whether or not such a creditor exists, and (3) a creditor who upon the date of bankruptcy

obtained a lien by legal or equitable proceedings upon all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists. If a transfer is valid in part against creditors whose rights and powers are conferred upon the trustee under this subdivision, it shall be valid to a like extent against the trustee. In cases where repugnancy or inconsistency exists with reference to the rights and powers in this subdivision conferred, the trustee may elect which rights and powers to exercise with reference to a particular party, a particular remedy, or a particular transaction, without prejudice to his right to maintain a different position with reference to a different party, a different remedy, or a different transaction.

d. After bankruptcy and either before adjudication or before a receiver takes possession of the property of the bankrupt, whichever first occurs —

(1) A transfer of any of the property of the bankrupt, other than real estate, made to a person acting in good faith shall be valid against the trustee if made for a present fair equivalent value or, if not made for a present fair equivalent value, then to the extent of the present consideration actually paid therefor, for which amount the transferee shall have a lien upon the property so transferred:

(2) A person indebted to the bankrupt or holding property of the bankrupt may, if acting in good faith, pay such indebtedness or deliver such property, or any part thereof, to the bankrupt or upon his order, with the same effect as if the bankruptcy were not pending:

(3) A person having actual knowledge of such, pending bankruptcy shall be deemed not to act in good faith unless

he has reasonable cause to believe that the petition in bankruptcy is not well founded;

(4) The provisions of paragraphs (1) and (2) of this subdivision shall not apply where a receiver or trustee appointed by a United States or State court is in possession of all or the greater portion of the nonexempt property of the bankrupt;

(5) A person asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided in this subdivision and in subdivision g of section 21 of this Act, no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee: Provided, however, That nothing in this Act shall impair the negotiability of currency or negotiable instruments.

e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent or against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate: *Provided, however,* That the court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the trustee shall succeed to and may enforce the rights of such transferee or obligee. The trustee

shall reclaim and recover such property or collect its value from and avoid such transfer or obligation against whoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision e is valid under applicable Federal or State laws.

(3) For the purpose of such recovery or of the avoidance of such transfer or obligation, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction.

f. The court shall appoint a competent and disinterested appraiser and upon cause shown may appoint additional appraisers, who shall appraise all of the items of real and personal property belonging to the bankrupt estate and who shall prepare and file with the court their report thereof. Real and personal property shall, when practicable, be sold subject to the approval of the court. It shall not be sold otherwise than subject to the approval of the court for less than 75 per centum of its appraised value. Whenever a sale of real or personal property of a bankrupt is made by or through an auctioneer employed by the court, receiver, or trustee, the auctioneer must be a duly licensed or authorized auctioneer in the place where the sale is to be conducted.

g. The title to property of a bankrupt estate which has been sold, as herein provided, shall be conveyed to the purchaser by the trustee.

i. Upon the confirmation of an arrangement or plan, or at such later time as may be provided by the arrangement or plan, or in the order confirming the arrangement or plan,

the title to the property dealt with shall revest in the bankrupt or debtor, or vest in such other person as may be provided by the arrangement or plan or in the order confirming the arrangement or plan.